DOW THEORY LETTERS INC.

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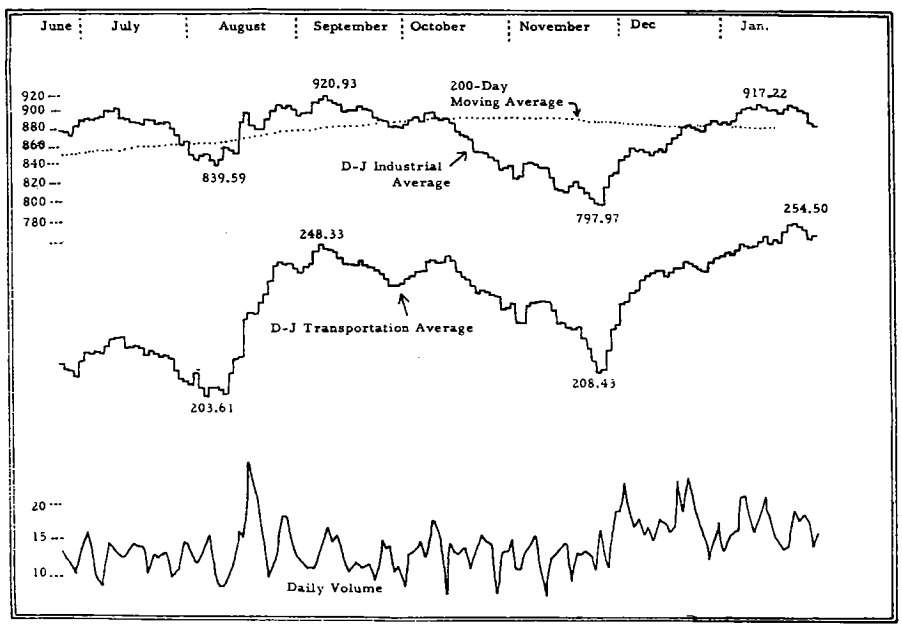
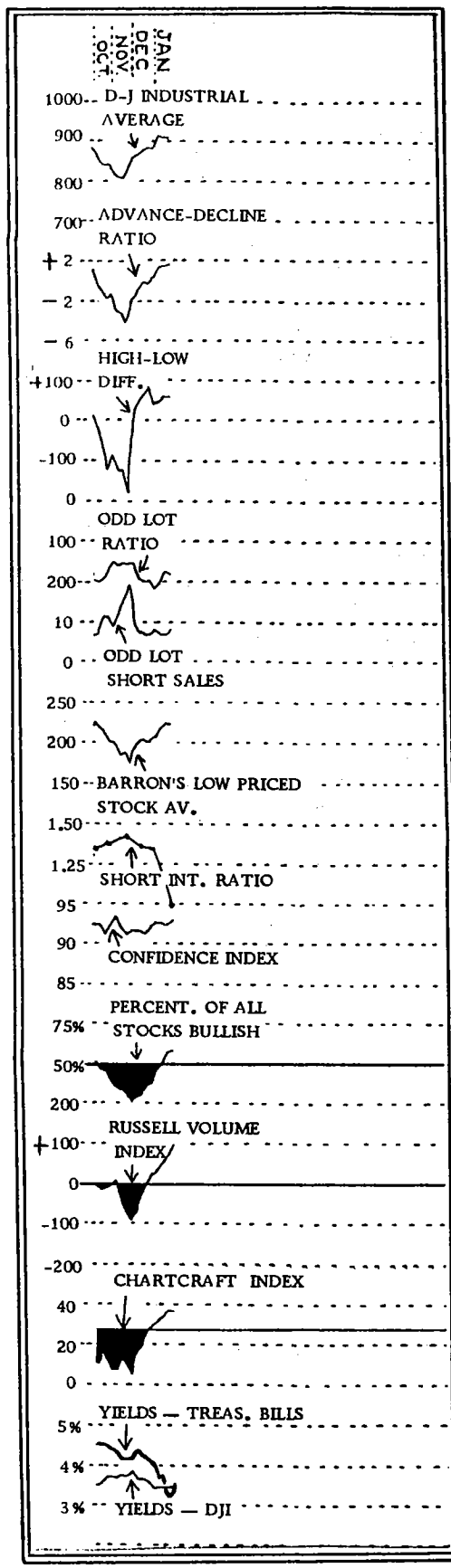
THE PICTURE: Last week provided a few shockers. The first came when the Commerce Dept. announced that the 1971 GNP was not what it was cracked up to be. The GNP for the second quarter was lowered by $3 billion and for the third quarter it was lowered a whopping $7 billion. Therefore, tax receipts will be lowered. And instead of the $11.6 billion deficit which Mr. Nixon promised us for fiscal 1972, we are told that we may have a $40 billion deficit. And according to other sources, the actual final 1972 budget deficit may be near $50 billion!

But the 1973 fiscal affair is even more of a shocker. Mr. Nixon announced that the planned budget deficit for 1973 will be a towering $25 billion (remember that's only the estimate!). In other words, this Administration is preparing to run a $25 billion deficit following perhaps a $48 billion deficit (1972) for a three year total of probably around $85 to $95 billion in the red. If you remember, this Administration originally ran on a ticket of "fiscal responsibility". For lack of fiscal principles, naked ambition, monetary obtuseness, and sheer wishful thinking, there have been few Administrations like this one in American history.

And through it all the inferences are painfully clear. The American people are not being fooled, nor is Wall Street, nor are our foreign creditors, nor are central banks the Free World over. This Administration is pulling out all the plugs in its frenzied headlong drive to capture the 1972 elections. The economic policy of the nation is to be ultra-expansionary with more Federal spending and more monetary pump priming. Perhaps the single area which most frightens the Administration is that of unemployment, and with a rocketing deficit and a boost in spending all around, it is hoped that somehow unemployment will be reduced to a more politically palatable figure. Will the fates let it all happen? I wonder.

This Administration is playing a reckless game of craps with the American economy, while mortgaging the future of countless generations to come (unless the entire U.S. economic structure is to be written off as a hopeless mountain of unredeemable debt, a never-to-be-paid-back I.O.U. which splatters like a tide





 of red ink in the face of the world).

In history, great nations have become weak nations and weak nations have become great ones. Spain was once the leader of the world, Holland was once a world power as werePortugal and Britain. When their economies and ability to trade deteriorated, their power deteriorated.

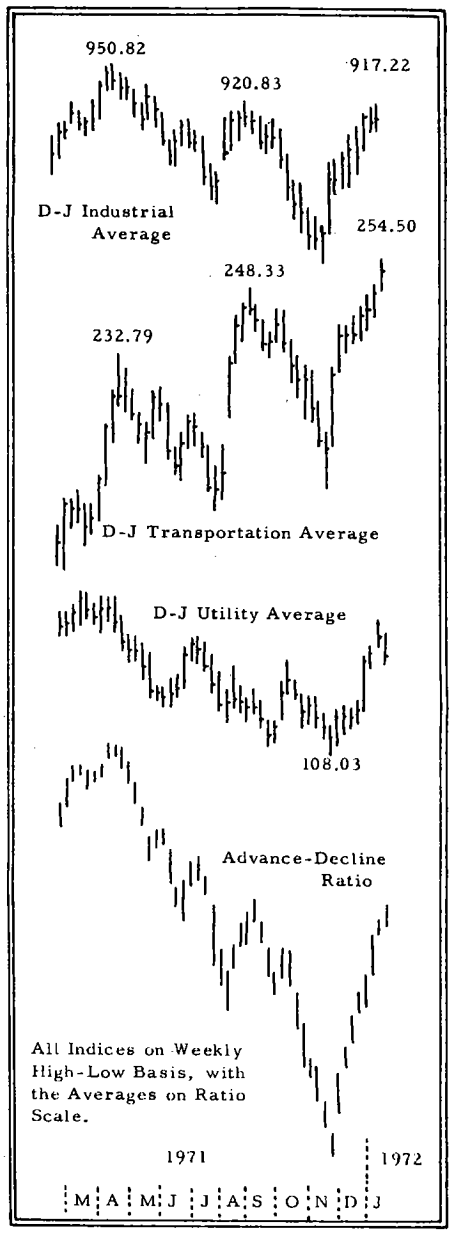
The U.S. has been in a position to lead the world by its example, to lead to a saner, better, more moral existence. It can not do this if its economy, and its currency decay. This is the path we are now on. If it occurs, we will have lost an opportunity which could have been the light and the inspiration of the entire world, both Free and Communist.

Already European leaders are turning elsewhere for leadership, and there seems a good chance that during the next few years Europe will assume the forefront (probably in a joint effort) in Free World monetary affairs. Furthermore, if a European international reserve currency is established, the U.S. would have its choice of getting its own house in order or becoming increasingly isolated in economic affairs. The reason: No one would want to trade with a nation whose currency is of questionable value.

To turn to the market itself, Wall Street now has the problem of deciding whether Mr. Nixon's continuous shots of heroin into the U.S. economy will send the patient staggering out on one more "high", or whether the latest massive pre-election "fixes" will represent a fatal "overdose". In the last Letter I drew particular attention to the latest non-confirmation which has developed between Industrials and Transports. This is seen on the page 1 chart as Transports pushed above their September, 1971, peak of 248.33 to a 1972 peak of 254.50 (Jan. 18). But note that Industrials have failed to confirm and have halted short of their own September high of 920.93 (the 1972 peak of January 18 was 917.22).

The seriousness of the situation can be best appreciated by turning to the weekly chart on this page. Here we see the extraordinary series of non-confirmations with successive ascending highs of 232.79, 248.33 and 254.50 in the Transports and successive descending peaks of 950.82, 920.83 and 917.22 in Industrials. This represents one of the most outstanding areas of non-confirmation in the history of the Averages.

In the last Letter I also drew attention to the weekly new high-new low differential on the N.Y.S.E. Remembering that the peak for the differential was set on the week ending December 23, 1971, at 191, last week (with a high-low differential of 185) again failed to better the December mark.



Finally (see Letter 517), the short interest ratio for the 30 Dow Industrial stocks dropped in the latest (December-January) period to .44, representing the fourth lowest monthly reading since this series was started in May, 1931. If there is any technical support for the Dow Industrials, it doesn't show on the Dow short interest ratio.

Monday (January 24) opened with a 10 point break in Industrials, wiping out almost all of January's gains. More important it gives us the marker points of 917.22 (Industrials) and 254.50 (Transports) on the upside. If the two Averages can better those figures, Mr. Nixon may yet have the nation swirling to the music of his monetary drugs. If not, then we may be in for some mighty interesting surprises before 1972 is out.

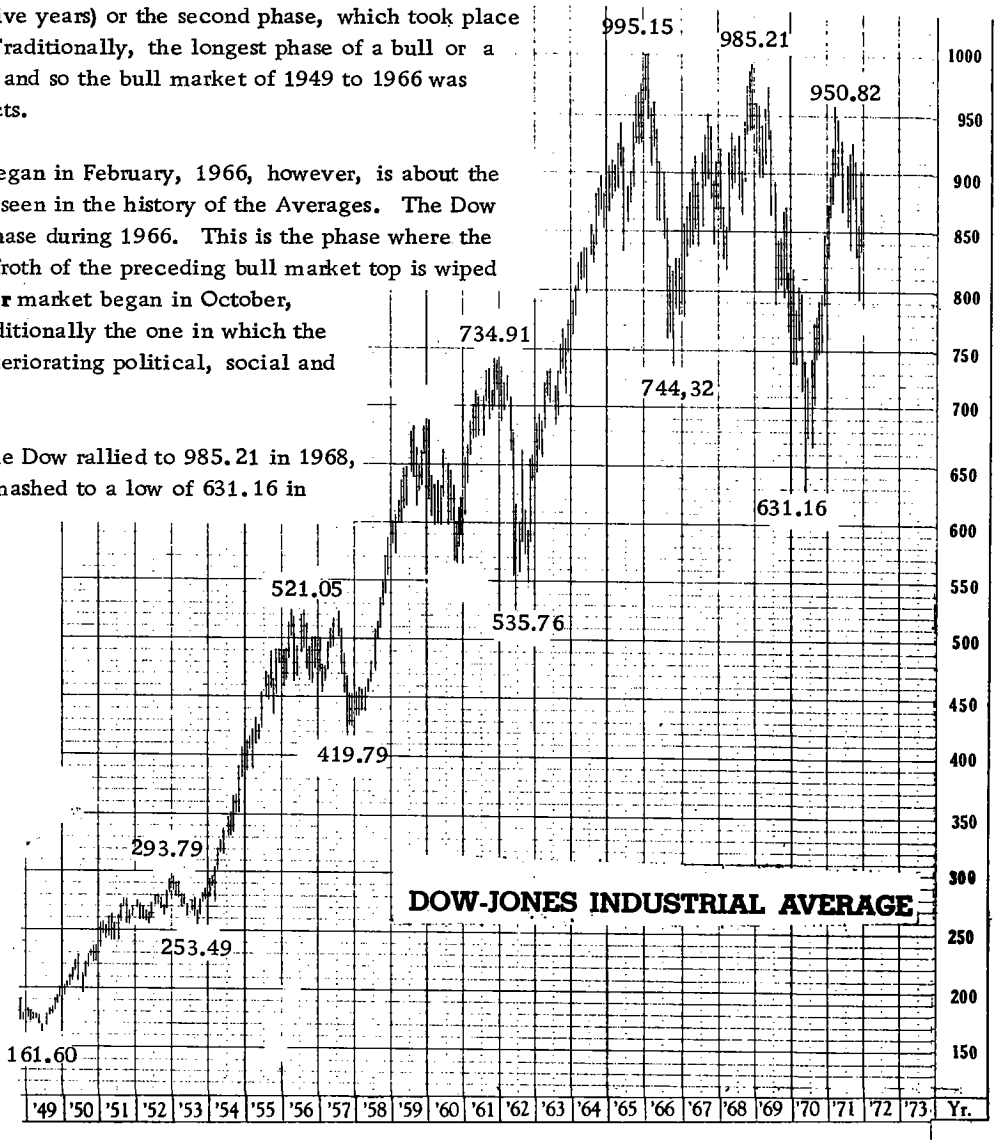
PERSPECTIVE: The page 3 long-term (monthly) chart is from M.C. Horsey (Salisbury, Md. 21801). I have filled in the Dow closings at critical highs and lows of the past 22 years.

The chart shows the primary bear market which began in June, 1949, at 161.60 on the Dow and terminated in February, 1966, at 995.15. The bull market was outstanding for its duration (17 years) and extent (834 points or 517%). The bull market was also extraordinary in that it drew in the largest slice of the public in stock market history, and in so doing produced some antics which were most confusing and unorthodox. For instance, it produced a "false" bear signal during 1957, and another one in 1962. And it produced a third (speculative) phase which lasted from 1958 to 1966 or nine years. This was longer than the first phase

which lasted from 1949 to 1953 (five years) or the second phase, which took place from 1954 to 1957 (four years). Traditionally, the longest phase of a bull or a bear market is the second phase, and so the bull market of 1949 to 1966 was unorthodox in a great many respects.

The primary bear market which began in February, 1966, however, is about the most unique structure I have ever seen in the history of the Averages. The Dow Industrials completed their first phase during 1966. This is the phase where the market declines as the foam and froth of the preceding bull market top is wiped out. The second phase of the bear market began in October, 1966, and the second phase is traditionally the one in which the market declines in response to deteriorating political, social and economic conditions.

But instead of a major decline, the Dow rallied to 985.21 in 1968, turned down in early 1969, and smashed to a low of 631.16 in 1970. From there, a new major correction took the Dow to 950.82 in April, 1971, and by November, the Dow was back to 797.97. The latest upward move has lifted the Dow to 917.22 on January 18, 1972. What we have had since 1966 is an extraordinary series of declines and advances all within the range of the 1966 peak of 995.15 and the 1970 low of 631.16.



I have discussed the reason for the stubborn corrections in this bear market many times, but suffice it to say that the "returns" to the above-900 area have been engineered by massive Government manipulation and propaganda, to say nothing of a towering national debt which will hit $246 billion for the new fiscal year (see news clip). During the period since 1966 the U.S. coinage has been debased (the silver content has been removed), the U.S. gold stock has been utterly depleted and gold embargoed, the dollar is selling far under the free market price for gold and will shortly be devalued, and the U.S.'s ability to compete in world markets has been badly undermined (see "Output per Manhour" chart). Last year the U.S., in the face of rising imports and sluggish exports suffered its first trade deficit since 1893. Meanwhile, the rise in the money supply resulted in a flood of greenbacks which swamped the Free World. With this type of operation on the part of the Government, the stock market was literally ballooned up to and above the 900 level. The incredible thing is that the 995.15 peak of 1966 has held during this systematic debasement of U.S. currency, wealth, savings and assets.

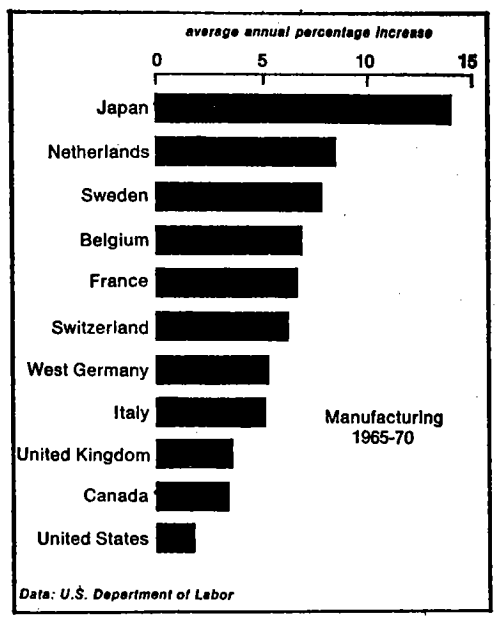
If we study the monthly chart, it would appear that the entire structure from February, 1966, to date represents a huge, five-year "top", a roof over the market which dwarfs anything seen before in stock market annals. During this period of repeated whipsaws, the public has "lost its shirt" and is

By a WALL STREET JOURNAL *Staff Reporter*

WASHINGTON — The Treasury asked Congress to boost the federal debt limit $50 billion to help cover the large budget deficits forecast for fiscal 1972 and 1973.

The increase, the largest ever requested, would lift the temporary ceiling on the federal debt to $480 billion from the current $430 billion.

Output Per Manhour



 now reduced to odd-lot selling on balance year after year, and redemptions of their mutual funds. Ever since 1965 the public has been hearing its elected leaders promise a Dow well over 1000 with fun and profits for all. But the bear has had different plans and no amount of coaxing and cajoling out of Washington has been able to put the Dow over the 1000 level. Nevertheless, we are told by no less an authority than our Secretary of the Treasury, Mr. Connally, that 1972 will see the Dow over 1000 or even 1100.

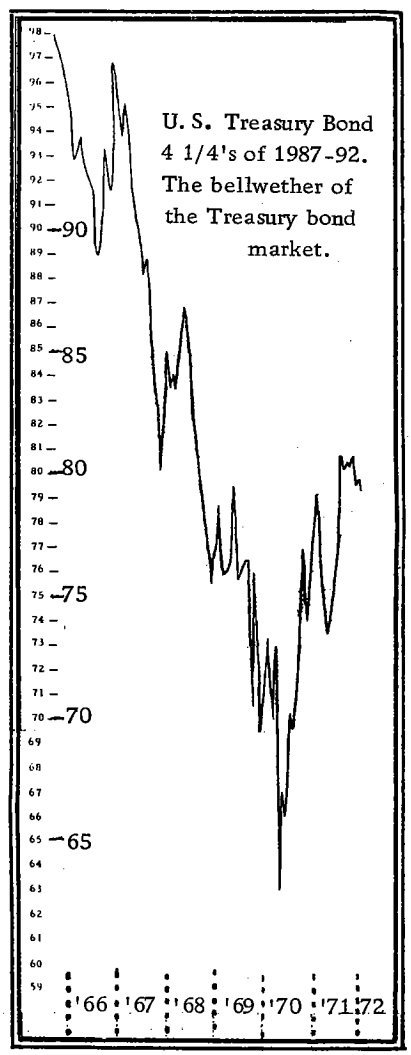
The power to put the Dow over 1000 does not reside with the U.S. President, his Secretary of the Treasury, Congress or any man or group of men. I am much afraid that our leaders in Washington are confusing arrogance with real power. They should know better. If arrogance was power, the Dow would be around 5000 now.

BONDS: This seems like a good time to discuss bonds, and I say this because I believe interest rates are currently "bottoming out". The U.S. has recently revised its GNP figures downward, and this means that tax receipts are going to drop below expectations. U.S. officials now admit to a possible $40 billion deficit for the year ending July 1, 1972, and according to reports this figure is climbing almost daily. The more reliable figure which I have heard is a budget deficit of $48 billion or higher! (The January official budget deficit prediction was $11.6 billion, if you remember).

Already, this astounding deficit is putting pressure on the money markets, where with new bond issues, new stock issues and now a rocketing Federal budget which will all have to be financed, interest rates are starting to climb (while bonds head down).

Now in view of this, it might be well to discuss the merits and penalties of holding bonds. First, the dangers of holding a bond can be (1) the bond defaults, (2) the bond declines in value due to a downgrading of its safety-value or a rise in interest rates in the market, (3) inflation eats away at the bond's value, (4) since bonds are traded daily and their prices fluctuate daily, one may be forced to sell even a high-quality bond at a loss if one needs the money and the bond at the time is below the purchase price.

Now, on the plus side, (1) a high-quality (Aa or Aaa) bond should not default, (2) a bond is a debt instrument and unlike a common stock, it must receive its stated interest or the company can be thrown into receivership, (3) an old bond (with a low payout) may be purchased in an area of generally high interest rates at a great discount. The bond may be held until interest rates decline or until maturity (either one) and then sold at a profit. The rise in the bond price is a capital gain.



For example, let's take a deep discount bond with a blue-chip or unquestioned background which is now on the historical "bargain counter". Such a bond is the U.S. Government 4¼ of 1987-92, or the Treasury bond which pays $42.50 interest (payment semi-annually) for each bond which will mature in 1992 at $1000. Because these bonds were issued many years ago when 4¼% interest from the Government was considered adequate, they are now selling at a big discount. The current price is 79 ($790) which means that they yield about 6% if purchased today.

Now suppose you buy one of these bonds, and within a year the economy collapses and interest rates head way down. This bond, if general interest rates return to 4¼ for Government bonds, would rise to the point where they would again sell for $1000 (more if interest rates drop below 4¼%). At any rate, at 1000 you would show a 26% capital gain plus about 6% interest on your bond. In other words, from today's 79, this bond would rise to 100 or a capital gain of $21, plus the 4¼% interest payable to the bond holder.

Now the potential danger is that interest rates may start climbing and perhaps never again get down to 4¼%. If they start climbing, the bond will sink even lower (below the current 79) since the 4¼'s will be even less competitive in the market, and the holder will be "locked in" to a bond that does not mature until 1992. That means that if interest rates never go below the current area, the holder of the 4¼'s of 1992 will have to wait 21 years to get back the full $1000 on these bonds. However, during all that time the holder will be getting an average of 6% on his money (figuring the 4¼% interest the bonds pay plus the appreciation from today's $790 to 1992's $1000).

Personally, I would guess that somewhere in the next five years general interest rates could easily decline to where the 4¼'s of 1992 would sell considerably above their current price of 79. But since nothing is certain, I would only put part of any capital in

these bonds. I would say a good percentage would be 20% to 25% for the average investor. And I would treat any such investment as a very long-term holding, but a holding which could be sold at a profit any time interest rates really collapse (at which time the blue chip stocks would probably be selling on the bargain counter).

By way of illustrating the recent movements in Treasury bonds, I am including my chart (page 4) of the bellwether 4¼'s of 1987-92, the Government bond which most dealers and professionals watch. I might add that the 4¼'s have had a good rally since the 1970 lows. Therefore, since I foresee climbing interest rates, it might be well to wait and purchase any new bonds towards the latter part of 1972 (or perhaps make half your commitment here and half towards the second half of the year).

MONEY AND GOLD: I am including this extraordinary chart through the courtesy of Investment Guideline, 200 Bay St., Toronto, Ont. The chart traces the price of gold since the year 1250, and Investment Guidelines makes the observation, "Whenever anyone can set forth circumstances dire enough to require an upward revision for the price of monetary gold, they are also suggesting a period of terrible times.....There simply is no way in which stable economic and social balances can be made to endure without a sound monetary system".

In the last Letter (518) I discussed some of the requirements for a sound monetary system, including the necessity of some powerful nation to play "banker to the world". I also outlined some of the attributes which the banker must have, including a good reserve position, an unquestionably convertible currency, a healthy balance-of-payments position, and the power to make everyone "play by the rules". I noted that the U.S. now lacks all attributes to play banker to the world, leaving a huge gap in the international monetary system for the first time in the memory of any living man.

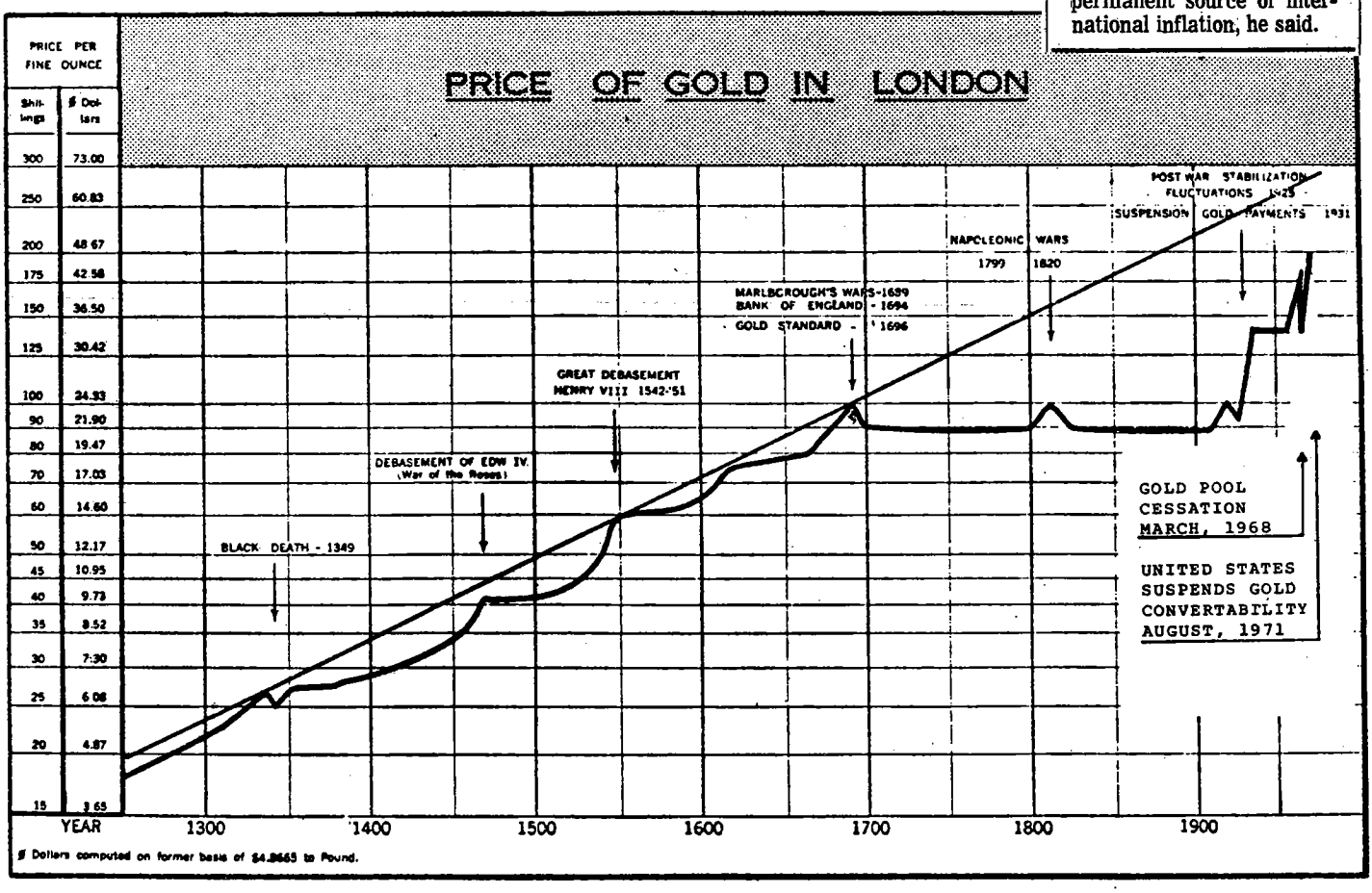
I don't know if Finance Minister Schiller of Germany reads these reports, but the accompanying news clip appeared in the January 20 paper. Evidently, Europe is awakening to the uncomfortable fact that the U.S. is finished as banker to the world and the dollar has collapsed as an international currency.

DOLLAR ROLE CALLED PAST

BONN (UPI) — West German Finance Minister Karl Schiller told the Bundestag yesterday the role of the U.S. dollar as a world reserve currency is ended. He urged Europe to take the initiative in international monetary and trade policy.

The United States clearly is no longer prepared to subordinate its economy and its monetary policy to the responsibilities of a reserve currency nation, Schiller said. A reserve currency is one which other nations use as a basis of trade and exchange.

Balance-of-payments deficits must no longer be a permanent source of international inflation, he said.



There are two ways of viewing this situation. One way is to say, "Why should we be saddled with the duty of providing a reserve currency? Why should we be the most powerful nation in the world, what good does it do us, and do we even want that position? Why should the dollar be saddled with disciplines growing out of the needs of a reserve currency? Let the world come up with another reserve currency, and leave us alone to inflate or do anything we want."

The opposing view would say, "The U.S. has been the moral, economic and social leader of the world since World War I. Now, because we are too lazy, debauched and undisciplined to lead sane and decent lives, and because we have become used to living way beyond our means, the dollar has fallen. We are running huge trade deficits, the national debt is skyrocketing, and the dollar, after having been helped out by realignments in other currencies, is hitting the floor again."

Furthermore, the billions of dollars which have piled up overseas in support of other currencies are not coming back to the U.S. (following the realignments), despite all official expectations. They are staying overseas, gathering higher returns on higher interest rates, but more importantly they are awaiting further weakness in the dollar. No one would have believed it but it is happening. Dollar balances are actually continuing to build in Europe, speculating against the U.S.'s ability to weather the economic storm!

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I received a letter this week from Douglas E. Johnston of Texas, and the letter came following a talk I had with Alden Wells in which I mentioned Johnston's sensational gold article in the current Wells "Quarterly" publication. Johnston states that S. Africa's selling of its gold reserves are over, the country is now running a favorable trade balance (after devaluing the rand), and therefore S.Africa's "battering down" of the free market gold price is over.

I am also including my daily chart of the London dollar gold price, so subscribers can get a better "feel" of what is going on in the free gold market. To put it mildly, one must say that the bullion price is exploding. Note the minor decline following the all-time high (of over $46) in early January. Then the new record high of $46.20 on January 26.

Meanwhile, my roaming friend,Dr. Harry Schultz,has come out with a brilliant report on the S. African golds, and he likes Kloof, Elsburg, Western Areas, President Steyn and Hartebeestfontein among others for purchase. He also likes American-South African Investment Trust, and I agree with him all along the line. The gold shares should benefit handsomely from the new high "average price" for gold in the free market, and I feel that this is still an accumulation area for a major gold share move which will come sometime during 1972 to 1975. When it comes it should be a sight to behold, particularly since golds haven't a friend on Wall Street, in Washington or in the wire houses. So far, they've only been purchased by people "in the know", and those long on patience.

From the Kaffir Chart Service (Palisades Pk., N.J. 07650) I am publishing a chart of the S. African gold mines index. As you can see, the index appears to be forming a good "bottom", and I would think the lows have been seen on the S. African gold shares. From here on, it should be an important move on the upside for the S. African gold shares.